
Policy Choices for Alleviating Difficulties in Micro and Small Enterprises (SMEs) Financing

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Contents

1. SMEs' Functions and Characteristics
2. Enterprise Perspective of SME Financing Difficulties
3. Finance Perspective of SME Financing Difficulties
4. Policy Perspective of SME Development
5. Policy System for Supporting SME Development
6. Institutional Arrangement for Supporting SME Development in China
7. Financial Arrangement for Supporting SME Development in China
8. Latest Policies for Supporting SME Development in China



1. SMEs' Functions and Characteristics

➤ Functions

- ◆ Employment enhancing
- ◆ Technology innovation
- ◆ Wealth creation

➤ Characteristics

- ◆ High specialization
- ◆ Small scale in assets and operations
- ◆ High proportion among enterprises and employees
- ◆ Large flexibilities
- ◆ High risks
- ◆ Difficult access to mass financial support
- ◆ Low capability in internal financing

1. SMEs' Functions and Characteristics (Continued)

- Aspects of SME Financing Difficulties
 - ◆ No access to continuous fund flow for operation and development
 - ◆ Hard to get standard interest rate loans
 - ◆ Few options in financing channels

2. Enterprise Perspective of SME Financing Difficulties

- Unclear development target
- Small enterprise scale and low employee education
- Nonstandard corporate governance
- Disordered accounting records
- Serious shortage of mortgage
- Unclear objective, path and mode of financing seeking
- Lack of knowledge in financial operation
- Taxation problems
- Insufficient competitive power in key business

3. Finance Perspective of SME Financing Difficulties

➤ **Banks**

- ◆ Fund constraint in small banks under monetary contraction policy
- ◆ Structure of deposit institutions
- ◆ Asymmetry in cost-benefit due to interest rate regulation
- ◆ Lack of technology and expertise in staffs
- ◆ staff's personal responsibility in SME lending
- ◆ Fiscal subsidy to SOE

➤ **Financial Markets**

- ◆ Unaccommodating of entrepreneurial enterprises in A-share market
- ◆ Restrains in enterprise debt issuance
- ◆ Incomplete guarantee system
- ◆ Opportunistic behavior in PE market
- ◆ Underdeveloped rental market

4. Policy Perspective of SME Development

- Supporting SMEs' development is a common task of many countries and regions for their functions in employment enhancing, technology innovation, international competitive power boosting, and social stability.
- An all-around policy mechanism involving law institution, fiscal and administration measure, policy and market-led finance, and social assistance is needed to solve the problems in SME development.
- Several issues needing clarification:
 - ◆ Supporting SEMs' development doesn't mean to abandon the principle of market competition.

4. Policy Perspective of SME Development (Continued)

- ◆ Supporting SEMs' development doesn't mean to abandon industrial policy.
 - ◆ Supporting SEMs' development doesn't mean to abandon market regulation.
 - ◆ Supporting SEMs' development doesn't mean to give up formalization in enterprise operation.
 - ◆ Supporting SEMs' development doesn't mean to push them to grow.
- Policy system and mechanisms supporting SEMs' development should be targeting, flexible, and subtle.

4. Policy Perspective of SME Development (Continued)

- SMEs' operations need accommodation and shouldn't be measured and regulated with general enterprises' standards.
- The key to support SMEs' development in China is to implement the items about corporate debt in the Corporate Law and the Securities Law.
- More fiscal subsidies and tax preference policies should be given to SMEs in view of enhancing employment.

5. Policy System for Supporting SME Development

- Including the financial support to SMEs into government budget
- Increasing tolerance for the bad loan ratio of SME loan
- Accelerating the development of financial markets related to SMEs financing
- Establishing special institutes to dispose of the problems in the process of SMEs financing
- Building information platform for SMEs' demanding and development to increasing the transparency of SMEs' operation
- Pushing forward the financial cooperation and capital restructure of SMEs when circumstance permits

6. Institutional Arrangements for Supporting SME Development in China

The 6 aspects of Chinese government's policies

- Supporting SMEs' technology innovation. In 2010, the central government appropriated 1.4 billion RMB of SME innovation fund, 27.3% higher than the number of last year, and 300 million of fund for conversion and application of agriculture technology innovations.
- Pushing forward the construction of credit guarantee system and improving the environment for SMEs financing. The central government continue to support the development of SME credit guarantee institutions, and guide financial institutions to launch small business secured credit.

6. Institutional Arrangements for Supporting SME Development in China (Continued)

- Implementing tax preference policy for SMEs, including 20% income tax reduction for small enterprises earning little profit, 15% income tax reduction for hi-tech enterprises, and a income tax reduction proportion to investment volume for entrepreneur enterprises in special areas.
- improving the government procurement system and expand SMB market space. The Ministry of Finance has issued the “SME Management Practices in Government Procurement” to promote the Governments at all levels of government procurement funds to SMEs tilt.

6. Institutional Arrangements for Supporting SME Development in China (Continued)

- Cleaning up the administrative charges and reducing the burden on SMEs. From September 1, 2008 onwards, unified individual industrial and commercial households stop collecting management fees and management fees bazaars, reducing the burden of individual industrial and commercial households and private enterprises, promoting fair competition in the main market operators.
- Enhancing the support to SME loans and agriculture-related loans. The Ministry of Finance has issued “The Notice on the Deduction on the Loan Loss Reserves of Financial Enterprises’ Agriculture Loan and the SME Loans”(2009), “Provisional Procedures for the Management of New Rural Financial Institution-Oriented Subsidies”(2009) and “Provisional Procedures for the Management of Rural Financial Institution-Oriented Subsidies”(2010).

7. Financial Arrangements for Supporting SME Development in China

- Since 2003, the People's Bank of China (PBC) has been promoting the reform of new type of rural finance and a group of small loan companies was set up.
- In 2006 China Banking Regulatory Commission (CBRC) announced the permission for the establishment of three types of rural financial institutions, i.e. village bank, small loan company, and funds mutual aid association.
- In July 2009 the CBRC proposed the goal to establish 1294 new type of rural financial institutions, including 1027 village banks, in 3 years. Up to the first quarter of 2011, 400 village banks was established, with the aggregate capital volume more than 30 billion RMB and the aggregate asset more than 100 billion RMB.

7. Financial Arrangements for Supporting SME Development in China (Continued)

- In 2008 the CBRC issued "Guiding Opinions of the China Banking Regulatory Commission for Banks to Establish Specialized Institutions Providing Financial Services for Small Enterprises" and "Circular of China Banking Regulatory Commission on Careful Implementation of the Neutral Policy for Further Improving Financial Services to Small-sized Enterprises" to encourage banks to improve their financial service for SMEs.

7. Financial Arrangements for Supporting SME Development in China (Continued)

- In 2009 the CBRC and the Ministry of Science and Technology jointly issued "Guiding Opinions of the China Banking Regulatory Commission and the Ministry of Science and Technology on Extending More Credits to High-tech SMEs" with the following contents:
- ◆ 1. Promoting a scientific and rational risk sharing system with participants ranging from government agencies to various investment funds, banks, high-tech SMEs, guarantee firms, etc., and direct banks to extend more credits to high-tech SMEs.
- ◆ 2. Refining the financing guarantee framework for high-tech enterprises and establish nonprofit specialized guarantee and re-guarantee institutions.
- ◆ 3. Pushing the science and technology administration at each level and the national high-tech park to establish loan risk indemnity funds for high-tech SMEs and formulate specific policies on subsidy, risk indemnity and award, supporting bank loans to high-tech SMEs.
- ◆ 4. Encouraging banks to develop specialized financial products for high-tech SMEs and issue intellectual property-guarantee loans.
- ◆ 5. Conducting innovative pilot projects on the cooperation mode between science & technology and finance in some bank branches.

7. Financial Arrangements for Supporting SME Development in China (Continued)

- In November 2011 the CBRC issued "Notice of China Banking Regulatory Commission on Supporting Commercial Banks in Further Improving Financial Services for Small-sized Enterprises", which included 10 preferential policies for banks to improve their financial services for SMEs. The regulation proposes for the first time that giving priority to supporting a commercial bank whose balance of loans to small-sized enterprise accounts for a prescribed proportion of its balance of loans to enterprises in issuing special-purpose financial bonds for making loans to small-sized enterprises, provided that the prudential regulation requirements are met, while exercising strict oversight over the movement of funds raised. It also suggests to conducting differential evaluation of the ratio of non-performing loans to small-sized enterprises and properly raising the tolerance of that while decreasing the risk weight of loans to small-sized enterprises to 75%.

8. Latest Policies for Supporting SME Development in China

In April 19, 2012, The State Council issued "Opinions of the State Council on Further supporting the Healthy Development of Small and Micro Enterprises" with the following contents:

I. Fully recognize the importance of supporting the healthy development of SMEs.

1. Strengthen the confidence to successfully fulfill the SME job.

II. Further enhance the fiscal and tax support for SMEs.

2. Implement the tax preference policies for SMEs.
3. Improve the fiscal supporting policies.
4. Establish State SME Development Fund.
5. Support SME development in government procurement.
6. Push forward the reduction and exemption of enterprise charge.

8. Latest Policies for Supporting SME Development in China (Continued)

III. Strive to alleviate the SMEs' financing difficulties.

7. Put into effect the financial policies supporting SME development.
8. Accelerate the development of small financial institutions.
9. Broaden the financing channels.
10. Enhancing the credit guarantee services for SMEs.
11. Standardize the financial services to SMEs.

IV. Further push forward the innovation and structural adjustment of SMEs.

12. Support SMEs' technology upgrading.
13. Increasing SMEs' innovation capability.
14. Improve SMEs' creation, application, protection and management of intellectual properties.
15. Support the development of innovative, entrepreneur, and labor-intensive SMEs.
16. Broaden private investment opportunities.
17. Accelerate the disposal of outdated production facilities.

8. Latest Policies for Supporting SME Development in China (Continued)

V. Increasing the support for SMEs' market exploration.

- 18. Innovate the marketing and commercial model.
- 19. Improving customs clearance services.
- 20. Simplify the process for domestic sales of processing trade.
- 21. Carry out the pilot project on IC industrial chain bonded area supervision model.

VI. Help SMEs to improve operation and management.

- 22. Support management innovation.
- 23. Improve quality management.
- 24. Enhancing human resource development.
- 25. Establish and improve the policies encouraging the employment of college graduates in SMEs.

8. Latest Policies for Supporting SME Development in China (Continued)

VII. Enhance the aggregate development of SMEs.

- 26. Reasonably allocate the lands for industrial clusters.
- 27. Improve the environment for the aggregate development of SMEs.

VIII. Enhancing the public services for SMEs.

- 28. Push forward the construction of service system.
- 29. Enhance the coordination and statistical supervision.

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